Purposeful capital: how can financial services support inclusive growth?

Inclusive growth requires long-term investment in people, places and industries. How can financial services business models be transformed?

Remarks by Greg Medcraft, Director for Financial and Enterprise Affairs, OECD
Global Parliamentary Network, London, 5 April 2018

We are here discussing inclusive growth because – as we heard from the Secretary General yesterday – the gains of economic growth in recent years have landed unevenly.

The social license to operate – what the community expects from business and government – is constantly shifting, often driven by social media and the 24 hour news cycle.

One thing is clear: businesses must put their customers unequivocally first – remember, the crowd includes customers**.** And part of this is meeting the demand for positive social and economic outcomes. I will expand on this in the next session.

For now I want to touch on three major shifts that are having huge effects on financial services business models and their consumers – and which will impact the ways finance can support inclusive growth:

1. Trust.
2. Digitalisation.
3. Globalisation.

Trust

Trust in governments and businesses has been low since the financial crisis. The Edelman Trust index has financial services as the least trusted industry.

Just 54% of the general population trust financial service providers to 'do the right thing'[1].

Trust is a fundamental pillar of financial services business models. The bigger the gap in trust, the more likely business models will be disrupted by innovative entrants offering better services and prices.

While financial services businesses have their role to play in maintaining and building trust, governments can assist.

A big part of this is financial consumer protection, which is necessary to maintain and build consumer trust in financial services.

- Policies must be nimble enough to protect consumers from potential harm whilst supporting growth and innovation. This is at the core of the G20/OECD Taskforce on Financial Consumer Protection's work.

[1] Edelmann trust Barometer 2018 (reporting on survey results from between October and November 2017)

The other side of this is financial education, so that consumers better understand – and better trust – financial products. This is a precondition to financial empowerment.

Adult financial knowledge is low. Last year's G20/OECD report on adult financial literacy found less than half of adults in G20 countries met the minimum standard of financial knowledge[2].

- The OECD is currently finalising policy guidance to the G20 on Digitalisation and Financial Literacy, which will provide international policy guidance on how digitalisation will impact financial literacy and financial education policies.

- And the OECD PISA test – the triennial international student assessment – measures financial literacy in 15-year olds, which provides an international benchmark to identify gaps in financial literacy and helps governments design policies to equip the next generation of financial consumers with the financial skills they need.

Incorporating a digital component to financial education is important because digitalisation is transforming the finance services industry business models.

Digitalisation

I see 5 major technological shifts that are having a significant impact on the world of business and particularly financial services:

1. Almost universal access to mobile telephones and internet.
2. Big data and predictive data analytics, including AI.
3. The development of blockchain.
4. Rising cyber-security risks.
5. Growing data privacy concerns.

There are opportunities here to enhance productivity and enable financial inclusion – but there are obvious risks too. I'll now discuss each briefly.

1. Access to mobile phones

The number of unique mobile subscribers expected to reach 5.9 billion by 2025, equivalent to 71% of the world's population[3].

Mobile delivery of financial services connects some of the most marginalised populations, many of which have little access to banking and financial services.

The experience of mobile money services like M-PESA in Kenya illustrates the reach and transformative power of mobile technology – ten years from its introduction, almost 80% of

[2] Based on a test in which participants had to reach a 70% target score to demonstrate a working understanding of personal financial matters. The test covered concepts such as compound interest, minimum credit card repayments, retirement income and investment diversification.
[3] GSMA (2018), The Mobile Economy 2018

Kenya's economy flows through mobile money systems, which are now expanding into investment and credit products.

2. Big data

'Big data' and predictive data analytics, including AI, are making sophisticated financial services more affordable and better suited to consumer needs.

For example, the OECD's recent report Robo-Advice for Pensions showed how the use of big data for advice can increase accessibility of investing for retirement to a broader market and at lower costs than traditional channels.

- There are also a competition risks here. Increasing use of algorithms could make it easier for businesses to achieve and sustain collusion without any formal agreement or even human interaction.
- There is also the risk of network effects coming from the dominance of large digital platforms like Amazon in the US or Tencent in China, which could use their market power to limit access to new entrants and thus competition.

3. Blockchain

Blockchain is a technology with huge potential across a wide range of applications. Its 3 main uses are:

1. Secure transfer and traceability of value.
2. Secure transfer of data.
3. Distributed nature of nodes makes it attractive for cyber-security and privacy.

Thanks to these characteristics, blockchain is facilitating innovative business models and new marketplaces, particularly in financial services, government services and supply chain management – driven by speed, disintermediation and lower costs.

I see Blockchain becoming a substantial force for financial inclusion.

4. Cyber security

The economic costs of cyber-crime were estimated at USD 1 trillion in 2017. It poses a great threat to the trust needed to harness the benefits of digital transformation.

There is potential for financial services, particularly insurance, to contribute to better cyber risk management for both individuals and businesses.

The OECD released a report on the role of insurance in cyber risk management in December 2017, which focused on the challenges impeding the development of the cyber insurance market, such as:

- clarity over coverage of cyber incidents in insurance contracts; and
- the lack of incident and loss data arising from cyber incidents.

5. Privacy

All of these market forces combine to raise fundamental questions around privacy.

Consumers have concerns about how personal data is collected, stored, shared and used. The answers to these questions will largely determine trust in, and adoption of, new financial technology that takes advantage of the benefits of digital transformation.

Globalisation

Financial markets are global.

We must cooperate internationally to mitigate risks and to make it possible for financial services business models to deliver the benefits of digitalisation.

This is necessary to:

- Exchange information and identify emerging best practices;
- Prevent regulatory arbitrage and avoid market fragmentation, which will enable efficiency and scaling of business.
- Establish greater legal certainty for investors and entrepreneurs.
- Raise awareness of the potential risks but also benefits.

The OECD played a strong role in restoring some trust to the financial industry after the financial crisis by developing and updating key global standards, including:

- the G20/OECD Principles on Corporate Governance; and
- the G20 High Level Principles of Consumer Protection.

In a time when technology is re-writing the financial services business models on an international scale, new standards and policy principles may be necessary. New avenues for cooperation should be explored. The OECD is well placed to enable this, and to help governments ensure these changes are met with better policies for better lives.